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BEFORE THE ARIZONA CORPORATION COMMISSION

JIM IRVIN
COMMISSIONER-CHAIRMAN
RENZ D. JENNINGS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

DOCKET NO. U-0000-94-165

IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.	**NOTICE OF FILING OF INITIAL BRIEF OF THE ELECTRIC COMPETITION COALITION**

NOTICE is given that the Electric Competition Coalition (ECC), Enron Corporation and Enron Energy Services, Inc. filed their Initial Brief.

RESPECTFULLY submitted this 16th day of March, 1998.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.

DOCKET NO. U-0000-94-165

INITIAL BRIEF

ON BEHALF OF

ELECTRIC COMPETITION COALITION,

ENRON CORPORATION, AND

ENRON ENERGY SERVICES, INC.

MARCH 16, 1998

INITIAL BRIEF .
ON BEHALF OF
ELECTRIC COMPETITION COALITION

MARCH 16, 1998

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The Electric Competition Coalition (ECC) strongly encourages the use of the divestiture approach and vigorously opposes the use of the net revenue lost approach. ECC believes the Commission could create the necessary incentives for utilities to unbundle their rates, identify any potentially strandable assets, and provide a framework for stranded cost recovery such that Arizona consumers shall have choice no later than January 1, 1999.

Considerable efforts were undertaken to make this a concise Brief. However, the voluminous 4300-page transcript of 35 witnesses, plus their prefiled and rebuttal testimonies and exhibits, merits careful attention. The following is a summary of what ECC believes to be the consensus developing around the various issues and ways in which the Commission may address these strandable cost issues.

I. No Significant Modification of the Rules Is Needed

Testimony during the hearings did not involve many major modifications of the Electric Competition Rules. ECC is of the opinion that the Rules do not need to be amended as a condition to progressing towards open competition. ECC supports the modification of the Rules proposed by Ms. Mona Petrochko of Enron in her Direct Testimony: (a) the expansion of wholesale or retail markets and services by regulated utilities should be provided for through an affiliate or unregulated merchant division, (b) lost revenues through utility discounts should not be recovered through stranded cost charges, and (c) stranded cost charges should be identified as a component of all customer rates, regardless of supplier.[1] Furthermore, ECC would not be opposed to the modifications proposed by Mr. Kevin Higgins of the Arizonans for Electric Choice and Competition (AECC) which addressed the allocation of stranded costs as contained Exhibit KCH-2.

II. Filing of Strandable Cost Recovery Should Begin Immediately

The utilities have been working up these estimates for years now. It is time for the Commission to take a look at those figures. If a utility is unwilling to disclose, one can only

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[1] Ms. Mona Petrochko Direct Testimony 23-27.

assume the utility is speculating on a windfall rather than actually needing recovery to stay solvent. As Ms. Mona Petrochko of Enron testified, Portland General was able to put together its customer choice filing, which included a divestiture proposal, within 6 months of the close of the merger with Enron Corp., and the Arizona utilities have had notice of these Competition Rules since December of 1996.[2]

III. Strandable Costs Include Hard Generation Facilities and Their Regulatory Assets and All Requirements Contracts.

Identifying the strandable costs appears to be quite easy, based on the testimony. These potential costs are essentially of three types: the hard generation assets, the regulatory assets related to generation, and any all requirements contracts to purchase generation. Going beyond these items would seem to merely open up a new "strandable recovery industry" that would be never ending.

Generation is the main category of stranded cost for Tucson Electric Power Company (TEP), with an estimated $400 million or so in regulatory assets, according to TEP Chairman Charles Bayless.[3] Dr. Kenneth Rose testified on behalf of the Commission staff that regulatory assets that have specifically ordered by the Commission may be treated differently that "production cost."[4]

IV. The Time Frame for Calculating Strandable Costs Is Not an Issue Under the Divestiture Approach

Proponents of the net revenues lost approach suggest that the calculation period should include the full life of the generation asset.[5] This exposes one of the many weaknesses of this approach. To allow all future costs to be brought back and included within strandable costs

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[2] Ms. Mona Petrochko Transcript 968:14 to 969:9. Transcript references herein are made to the Condensed Transcript and Concordance version.

[3] Mr. Charles Bayless Transcript 1512:14-18.

[4] Dr. Kenneth Rose Transcript 3084:24 to 3086:15.

[5] *See* Mr. Charles Bayless Transcript 1515:10-20.

would allow that generation to be competitive at today's prices even though its electricity will be sold under tomorrow's market conditions. It would make that generation less costly than that which could be supplied by those in the competitive market. It further assumes that all the consumers for which that generation was constructed left the utility's generation service immediately.

Divestiture is an attractive alternative because "any intelligent buyer when evaluating the price he is willing to pay for an investment would have to consider the operation and profitability of that investment over its expected lifetime, . . ," according AECC's to Dr. Alan Rosenberg.[6] Thus, divestiture avoids having to administratively determine what calculation period should be adopted and the time for calculating stranded cost is when the divestiture occurs.[7]

If there is no divestiture, Dr. Rosenberg recommends a "snapshot" of strandable costs be taken at the end of the transition period. That's when there is truly a competitive market for generation, as Dr. Rosenberg points out:

> The market value changes each year, the different perceptions of future market prices, different conditions, different supply, different demand, so the book value changes each year, the market value changes each year; therefore, the difference between those two change each year.[8]

V. Strandable Costs Should Not Be Collected Beyond January 1, 2003 -- when the generation market and all retail customers are open to competition

Recovery of strandable costs is a transition charge on consumers so that utilities may further adjust to open competitive generation. The duration of this recovery period should be as short as possible; definitely no later than when the retail competition door is fully opened. To continue beyond that time would delay the full benefits of competition to consumers and

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[6] Dr. Alan Rosenberg Transcript 2195:11-15.

[7] Dr. Alan Rosenberg Transcript 2203:19-25 and Mr. Kevin Higgins Transcript 4017:21 to 4018:3.

[8] Dr. Alan Rosenberg Transcript 2196:18-23.

clearly give utilities a marketing price advantage over other competitors, with subsidized generation costs.[9]

VI. Every Utility Customer Should Pay for Strandable Costs, Whether through a Component in the Unbundled Rate or as a Line Item on the Distribution Charge

A solid consensus appears on the principle that strandable costs should be spread among all consumers, whether they buy generation from the incumbent utility or someone else. Most suggested that this be a nonbypassable distribution charge divided among the various rate classes, "the revenue neutral approach," even though there were some differing opinions as to whether it should be on the capacity and energy components.[10]

Dr. Kenneth Rose recommended that the stranded cost charge would be a line item in the standard offer so "the customer could see how much they are paying for generation and compare that to what they could get elsewhere."[11] Dr. Richard Rosen said every state he is aware of is putting a line item on the electric bill.[12]

A variety of opinions were expressed on how to share strandable costs among consumers and between consumers and shareholders. For example, Dr. Mark Cooper testified that the

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[9] *See* Dr. Richard Rosen Transcript 1810:18-25 (". . . we recommend that the stranded cost recovery charge cease after the transition period [January 1, 2003] . . .); Dr. Kenneth Rose Transcript 3159:4-12 (". . . if you go beyond five years, it's just making customers wait too long to get to the benefits of competition. That is why we argue for as short as possible, and five years or less seems to be an appropriate line time [sic]."

[10] *See* Dr. Richard Rosen Transcript 1815:17 to 1816:23; Dr. Kenneth Rose Transcript 3103:10-3104:2.

[11] Dr. Kenneth Rose Transcript 3242:3-13.

[12] Dr. Richard Rosen Transcript 1894:2-7.

Commission could allocate a larger or smaller share to a particular class of customer, depending on the customers' ability to pass the charge through.[13]

VII. No True Up Will Be Necessary If Solid Evidence of Strandable Costs Is Presented Up-front

The "true up" notion is the companion of the net revenue lost approach. Over or under collection is a serious concern with that approach. Some suggest that an ongoing, administrative strandable cost program be instituted, either using forecast or hindsight data. The Commission should reserve the ability to correct any unintended consequences. Other than that, it would seem no true up is necessary.

TEP Chairman Bayless recognized that if there is a true up process each year that "some would claim that the utility had no incentive to reduce cost."[14] On that point Dr. Alan Rosenberg testified that the more utilities are at risk for stranded cost, the less need for a true up.[15] Dr. Kenneth Rose, on behalf of Commission staff, testified that a true up mechanism could really drag out the move to competition.[16]

VIII. Price Caps and Rate Freezes Are Generally Not Necessary, But the Commission May Wish to Not Allow Utilities to Increase Their Existing Rates, As Bundled or Unbundled, Until After January 1, 2003

For public confidence that some consumers will not be harmed at the expense of others, the Commission may wish to put a ceiling on the standard offer and the unbundled rates. A general consensus seemed to be built around this concept, even though market theorist typically oppose any type of artificial price barriers. The standard offer and the unbundled rates for those

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[13] Dr. Mark Cooper Transcript 2478:15 to 2479:5 (Dr. Cooper testified he worked on stranded costs in New York, Pennsylvania, and Virginia and the legislatures of 4 or 5 other states).

[14] Mr. Charles Bayless Transcript 1516:14-17.

[15] Dr. Alan Rosenberg Transcript 2267:10-16.

[16] Dr. Kenneth Rose Transcript 3101:2-4.

seeking competitive services should not be increased during the duration of the transition to full open competition -- January 1, 2003.

IX. Mitigation of Strandable Costs Is Highly Encouraged by the Market Approach and With a Short Time Frame for Recovery

Identification of specific mitigation factors is easy. Deciding whether the utility should have adopted them is not. Arizona Public Service Company (APS) witness Dr. William Hieronymus testified: "That if you say I'm going to give what you spend no matter what happens, obviously, you have no incentive to mitigate."[17] Because each utility is unique as to strandable costs, the consensus seems to be on market incentives for encouraging the utility to lower its costs -- by encouraging the utility to reduce costs and by limiting what share of strandable costs may be recovered. Another incentive for mitigation is to limit the recovery period; the shorter the time, the greater the emphasis on mitigating uneconomic assets and activities. Divestiture of uneconomic assets that may command a favorable market price ECC believes is the ultimate method in which to mitigate costs.

X. In Estimating Strandable Costs, There Is No Good Method, So the Utility Should Either Voluntarily Divest or Present Solid Evidence of the Market Value of Strandable Assets

Everyone seems to believe that the utilities are entitled to an opportunity to recover strandable costs (or at least a portion thereof). Everyone seems to feel that the utilities should be able to recover regulatory assets that are attributable to generation. Everyone seems to support the notion that utilities should recover reasonable strandable costs resulting from all requirement contacts. <u>Everyone agreed that a market price is needed in order to quantify these strandable costs.</u>

Market principles are embodied in all the approaches suggested. Dr. Kenneth Rose, for example, testified that the competitive market is the superior means of valuing assets.[18] The

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[17] Dr. William Hieronymus Transcript 2572:18 to 2573:11.

[18] Dr. Kenneth Rose Transcript 3154:1-4.

key issue is which market mechanism or proxy provides the most accurate information. False assumptions, variables and data could result in major windfalls, or shortfalls, to utilities and consumers. For that reason alone, we have supported the direct market valuation of any strandable asset, either through voluntary divestiture ("the true willing buyer and willing seller price"), arms length bilateral contract prices, or by using an appraisal.

Several states have experience with divestiture or mandatory separation of generation from transmission and distribution services: California, Maine, Massachusetts, Nevada, New Hampshire, New York, Rhode Island, and Nevada. In addition, voluntary divestiture has been proposed by Montana Power and Portland General, in their states.[19]

Voluntary or "incentive" divestiture was supported by many who testified. This market approach was endorsed by witnesses for the Arizona Consumer Council,[20] Department of Defense,[21] Enron,[22] PG&E Energy Services,[23] Citizens Utilities,[24] Navopache Cooperative[25] and the Electric Competition Coalition.[26] TEP Chairman Bayless indicated a willingness to look

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[19] Ms. Mona Petrochko Direct Testimony at 16-17; Transcript 981:3 to 982:12.

[20] Dr. Mark Cooper Transcript 2493:4-13.

[21] Mr. Ralph C. Smith Transcript 2699:11-14 (Mr. Smith preferred divestiture after testifying in California and Pennsylvania and using principles learned from participating in those proceedings).

[22] Ms. Mona Petrochko, Direct Testimony and Transcript 861:6 to 862:11.

[23] Mr. Douglas Oglesby Transcript 1298:24 to 1299:16.

[24] Mr. Sean R. Breen Transcript 98:3-17.

[25] Mr. Alan Propper Transcript 2086:11-21 ("I'm in favor of using a computation for identifying stranded costs that involves divestitures for those generating entities that wish to divest themselves of any of their generation.")

[26] Dr. Douglas C. Nelson Transcript 4177:14 to 4179:21, 4187:6 to 4188:4, and 4203:10 to 4205:10.

at the divestiture approach.[27] Ms. Betty Pruitt and the Arizona Community Action Association support the "bottom up asset-by-asset" approach and "some assets should be sold in the market (divested) and the resulting prices used as the market values in the analysis of stranded costs."[28]

Dr. Mark Cooper, on behalf of the Arizona Consumer Council, testified that he "would prefer the Commission to come from the position, we like divestiture, then if we're not going to get divestiture, then we're going to have severe regulation. . . if you prefer to divest under those circumstances, you will avoid severe regulation rather than get all kinds of economic rewards."[29] Mr. Albert Sterman, testifying on behalf of the Arizona Consumers Council, supported market-based approaches, such as the replacement cost method, but would support divestiture depending upon how it is structured.[30]

Dr. Alan Rosenberg, testifying on behalf of the Arizonans for Electric Choice and Competition, said: "My primary proposal is that I said divestiture as [sic] the most appropriate method," and "it's the most unequivocal, yes, and the fairest."[31]

Dr. Daniel Fessler, who testified on behalf of TEP, supported the divestiture approach in finding true market value of strandable assets. In describing the divestiture of 50 percent of non-nuclear facilities in California, Dr. Fessler indicated his two colleagues had some concern about market power, as a reason for such divestiture. But Dr. Fessler emphasized a second important reason for divestiture was to obtain true market value of the strandable asset:

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[27] Mr. Charles Bayless, Transcript 1527:5-11, and later in response to the Hearing Officer's question if he would prefer the auction versus net revenue lost approach, Mr. Bayless said: "I think I would choose net present value. I think Springerville was a good plant, but I would have nothing against the auction approach if that's what the Commission wanted to do." Transcript 1530:1-9.

[28] Ms. Betty Pruitt Direct Testimony p.3 and Transcript 256:3-5.

[29] Dr. Mark Cooper Transcript 2495:2-10.

[30] Mr. Albert Sterman Transcript 2348:1-13.

[31] Dr. Alan Rosenberg Transcript 2199:9-11 and 2243:1-6.

> Second, we also felt that selling units, while not mandating it, would be a very excellent way of valuing the units for purposes of trying to figure out what might be the stranded costs, because you would have an actual transaction as opposed to an appraisal. And so that was one of the ways in which the utilities were offered a means of quantifying, and it was in the utilities' interest to get that quantification accurate as early as possible because they only had a window of opportunity in which they had the opportunity to recover the stranded costs. So we saw it as useful from that perspective, but we emphatically did not require it.[32]

Department of Defense witness Ralph Smith pointed out that one clear advantage of divestiture is the sales price is going to be the highest price (in comparison to the administrative approach) and a second clear advantage is "that it's objective evidence in a transaction between a willing buyer and willing seller not acting under duress."[33] Citizens' Sean Breen said they support auction and divestiture "because it makes a clean break from regulation and gets us to competition expeditiously," and in talking with other utilities that have undertaken divestiture he estimated it would take 8 to 10 months to complete.[34]

RUCO's Dr. Richard Rosen said he was not opposed to the market or divestiture approach. In addition to addressing market power issues, he said "Another advantage of divestiture if that the retail market for generation services might become, might flourish at a higher degree sooner than it would otherwise."[35] Navapache's Mr. Alan Propper testified that the sale price of generation assets provided the most solid evidence of their market value.[36] ECC's Dr. Douglas C. Nelson testified that the risk to shareholders and consumers may be reduced as a result of divestiture, with improved bond ratings, because of a more stable net revenue stream from the remaining regulated distribution and transmission system. The risks

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[32] Dr. Daniel Fessler Transcript 522:21 to 523:9.

[33] Mr. Ralph Smith Transcript 2749:12 and 2750:5.

[34] Mr. Sean Breen Transcript 121:7-12 and 233:3-5..

[35] Dr. Richard Rosen Transcript 1894:18-21.

[36] Mr. Alan Propper Transcript 2113:6-11.

associated with future fuel prices and other generation costs would be shifted to the new generation owner and not ratepayers, as a result of divestiture.[37]

Mr. Kevin Higgins, testifying on behalf of the Arizonans for Electric Choice and Competition, said: "I find asset sale, auction and divestiture to be the most superior, the superior method for evaluating the assets, because it is a direct sale." However, because of the practical problems, particularly with the Palo Verde Nuclear Generating Station, he was recommending the "replacement cost valuation" as the best proxy for divestiture.[38]

Economist Enrique Lopezlira, testifying on behalf of the Attorney General's Office, supported the stock market approach, but "for noninvestor-owned utilities, an auction divestiture approach would probably be acceptable and appropriate."[39]

APS' Dr. William Hieronymus testified: "I think divestiture is something that utilities should consider in commissions where it's necessary on its own merits" and if he were a commissioner he would see some value in divestiture. However, he said it should not be used merely to simplify the stranded cost calculation, nor to tell companies which businesses they may be in. He indicated that divestiture was occurring in California, Massachusetts, New York and Rhode Island, with only the latter state requiring it for strandable cost calculations. [40] Mr. Jack Davis of APS also agreed that utilities should have the option to divest.[41]

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[37] Dr. Douglas C. Nelson Transcript 4186:11 to 4190:14.

[38] Mr. Kevin Higgins Transcript 4017:1-16; 4035:25 to 4036:5 and 4123:19 to 4127:7.

[39] Mr. Enrique Lopezlira Transcript 3951:15-20.

[40] Dr. William Hieronymus Transcript 2582:22 to 2583:15; 2606:13 to 2609:12; and 2584:1 to 2586:11.

[41] Mr. Jack Davis Transcript 3680:21 to 3681:3 and 3742:1 to 3747:24.

Several witnesses testified the recent sales of generation sold at several times their book values.[42] Even though some generation has sold for well above 2 1/2 times book, there still has been substantial stranded costs.[43] This emphasis the need for prompt divestiture, so as to "stop the bleeding" and the accrual of strandable costs.

Dr. Alan Rosenberg testified that he though the market approach would result in a sooner, more efficient competitive marketplace in Arizona, than would an administrative approach.[44] He reported on 11 divestitures that have occurred.[45] Montana Power Corporation, for example, is divesting of generation, and any net strandable costs after such divestiture may be recovered over a 4-year period, according to Dr. Rosenberg. If those generation assets bring more than book value, than the excess goes towards offsetting regulatory assets. Any residual after that will go to the ratepayers.[46] Dr. Rosenberg said divestiture was strongly encouraged in New York, by maximizing the shareholders value and that "there are many ways that commissions can encourage certain actions on parts of regulated utilities."[47]

APS did bid on generation assets in California. Mr Jack Davis said in figuring that value he would calculate the present value of the future income stream of the plant using a 10 to 12 year revenue stream with probably twice the regulated rate of return.[48] Others, including Ms. Mona Petrochko of Enron, the Defense Department's Mr. Ralph C. Smith, and Citizen Utilities'

[42] Mr. Sean Breen Transcript 112:9-12; Ms. Mona Petrochko Transcript 837:21-25; Dr. Kenneth Rose Transcript 3092:2-8 and 3145:17 to 3147:13.

[43] Dr. Richard Rosen Transcript 2020:25 to 2021:7.

[44] Dr. Alan Rosenberg Transcript 2229:22 to 2230:1.

[45] Dr. Alan Rosenberg Transcript 2246:14-24.

[46] Dr. Alan Rosenberg Transcript 2204:16 to 2205:19.

[47] Dr. Alan Rosenberg Transcript 2250:11-23.

[48] Mr. Jack Davis Transcript 3767:15 to 3768:16.

Mr. Sean Breen, discussed at length the methodology used in calculating the bid price and structuring the process for divestiture of generation plants and purchase power contracts.[49]

Dr. Eugene Coyle testified he had a client that participated in the auction process of Pacific Gas & Electric Company last year and it is participating in the second auction, including "must run" facilities.[50] Designation of "must run" units must be by an Independent System Operator, and those units may still be divested but there is no guarantee their status will remain the same given the new transmission and competitive generation environment, according to Ms. Mona Petrochko.[51]

Dr. Kenneth Rose testified on behalf of Commission staff and said that divestiture is not bad, but he felt it should not occur for the sole purpose of valuing assets. He went on to say that it should be voluntary and expressed concern that sales might impact market price if new owners pay above the book value. However, he did recognize that the new owners might be able to operate the plant more efficiently and did not dispute the fact that the new owners must sell the generation at market value regardless of the plant's purchase price.[52] Dr. Rose also conceded that an auction would probably reveal a higher value than under a "top-down" or net revenue lost approach.[53] Furthermore, he acknowledged it would be prudent for a utility to recover as much transition or stranded cost revenues and then the utility might explore voluntary divestiture.[54]

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[49] Ms. Mona Petrochko Transcript 835:10 to 839:24; Mr. Ralph C. Smith Transcript 2720:1 to 2722:25; Mr. Sean Breen Transcript 194:1-20.

[50] Dr. Eugene Coyle Transcript 1120:6-13.

[51] Ms. Mona Petrochko Transcript 1006:8 to 1009:18.

[52] Dr. Kenneth Rose Transcript 3091:2 to 3094:5.

[53] Dr. Kenneth Rose Transcript 3208:3-21.

[54] Dr. Kenneth Rose Transcript 3235:15 to 3236:1.

Dr. J. Robert Malko testified that the Commission could allow a greater percentage of stranded cost recovery if the utility divested itself of generation and whether it was voluntary or involuntary.[55]

If generation assets are not divested, then those assets could be appraised. APS witness Benjamin McKnight testified that the fair market value of generation plants could be determined from appraisals, " . . . based on a number of different factors, similar transactions, discounted future cash flows. There's various techniques that are employed."[56]

If a sale of generation does not occur, the appraisal method might compare long-term wholesale contracts, such as those entered into by APS, with adjustments to the full retail price, by adding the unbundled tariff components to that wholesale index. Dr. Kenneth Rose testified he would recommend calculating market price using a method similar to that used by Dr. Rosen -- "determine what a retail price is for the state."[57] Using only wholesale prices would be inappropriate, "because the average retail customer is not going to get that low of a price," and "utilities are getting their capital costs from their current captive customers," according to Dr. Rose.[58] These retail estimates would be higher than wholesale prices, and Dr. Rose believes the Dow Jones Palo Verde index would be "way too low."[59]

As suggested by Dr. Rose, the witness for the ACC staff, the net revenue lost approach need not be used for the actual recovery of strandable costs but might be used "to calculate or get an idea roughly of what the magnitude of the stranded cost problem is, and the direction to

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[55] Dr. J. Robert Malko Transcript 2160:7 to 2161:2.

[56] Mr. Benjamin McKnight Transcript 2415:8-14 and 2438:9-16.

[57] Dr. Kenneth Rose Transcript 3094:12 to 3095:11, 3165:22 to 3166:4.

[58] *Ibid.*

[59] Dr. Kenneth Rose Transcript 3095:8-11 and 3149:5-10.

see whether or not it is actually a positive or negative number."[60] Similarly, this could be one technique used in appraising the generation plant.

XI. The Net Revenue Lost Approach Is Fraught With Many Weakness and Should Only Be Considered a Barometer, But Not a Measure of Strandable Costs

Under the guise of the net revenue lost approach, some affected utilities are seeking to "lock" the Commission into the notion of a "regulatory compact" that entitles them to recover all revenue changes that might occur in the future, without regard to the effect competition will have on the utility.[61] Dr. Kenneth Gordon succinctly described this phenomenon: "The stranded issue arises when the incumbent utility finds itself with a revenue stream in the new world that it's being presented with that doesn't allow it to cover what it regarded as its traditional revenue needs . . ."[62] Recovery of strandable costs should be based only upon verifiable and unmitigated generation costs that cannot be recovered from a robust competitive environment, and the utility bears a high burden of proof.[63]

A. The Net Revenue Lost Approach Overstates Stranded Costs

The weaknesses of the net revenue lost approach were articulated by many of the witnesses. Estimates of stranded cost under this approach were only prepared by Dr. Richard Rosen on behalf of RUCO. He preferred to call this net revenues lost approach a "differential revenue requirements" approach which in some cases might be "a net revenues gain" approach.[64] A partial list of those shortcomings of the net revenue lost approach includes:

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[60] Dr. Kenneth Rose Transcript 3079:19-25.

[61] Dr. Douglas C. Nelson Direct Testimony at 6; Mr. Kevin Higgins Transcript 4038:9-14.

[62] Dr. Kenneth Gordon Transcript 697:3-15.

[63] Ms. Mona Petrochko Transcript 847:12 to 848:16.

[64] Dr. Richard Rosen Transcript 1822:5-16.

1. "But the problem is, we don't know the market price," according to TEP Chairman Bayless.[65]

2. "So if you picked today's spot market price and carried it forward in the future, it would definitely be too low," was also acknowledged by Mr. Bayless.[66]

3. "The market price is the key there, and also the hardest thing to forecast," according to Dr. Kenneth Rose.[67] He went on to say: "We don't have a market today in Arizona or anywhere in the country that we can look at and say with any degree of certainty or even probability, a high probability, that we know exactly what the price is going to be in this area."[68]

4. The longer you go out in calculating strandable cost, the less probable the number will be accurate, said by Mr. Bayless.[69]

5. A utility would have an incentive to run its less efficient plants because those cost may be recaptured through the net revenues lost approach, was suggested by Dr. Alan Rosenberg.[70]

6. With the net revenues lost approach, "then you really don't know how much you have attributed to each plant. So when you sell one plant you don't know is that a cause for increasing the rate or decreasing the rate. You don't know because you have never established that particular stranded cost for that plant," according to Dr. Rosenberg.[71]

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[65] Mr. Charles Bayless Transcript 1516:5-13: "There's an inherent conflict between a couple principles that everybody would like to achieve. One is everybody would like to have certainty. But the problem is, we don't know the market price. So if you choose certainty and say the market price is going to be 3.5 cents forever, and that's it, and you recover stranded costs and you walk away, there is a danger that the utility will over or underrecover."

[66] Mr. Charles Bayless Transcript 1517:20-22.

[67] Dr. Kenneth Rose Transcript 3081:22-23.

[68] Dr. Kenneth Rose Transcript 3082:5-11, and 3233:15-19 ("We are looking ahead to try to guess at what the amount of the cost is, and really that is the -- what it amounts to is nothing more than a guess, because we don't know, to the extent of the market price, what future demand is on that.")

[69] Mr. Charles Bayless Transcript 1515:21 to 1516:4.

[70] Dr. Alan Rosenberg Transcript 2241:23 to 2242:20.

[71] Dr. Alan Rosenberg Transcript 2257:14-21.

7. The utilities would "have a guarantee to recover their entire revenue stream that they are recovering today without any considerations of future inefficiencies," was another shortcoming of the net revenues lost approach testified to by Dr. Rosenberg.[72]

8. The net revenues lost approach seeks a return of and on capital which "embody significant unequal economic costs which violates the obligation to provide efficient electric service," according to Dr. Mark Cooper.[73]

9. "Utilities tend to be very heavy in administration," those costs should be controlled and reduced, and the strandable cost program should focus on uncontrollable sunk costs, according to Dr. Mark Cooper.[74] These costs may be misallocated to transmission & distribution services so as to make the utility's generation more competitive in other markets, and uneconomic administrative costs are implicitly recovered in the net revenues lost approach.

10. "[T]he mathematics of calculating the net revenues lost approach involved projecting all of the utility's anticipated costs on a forward-going basis that are associated with generation. That means operating costs, that means administrative and general costs, and in effect the result of the calculation is that for every dollar, say, of administrative and general costs that is projected, say, five years from now, that dollar, the present value of that dollar shows up as a dollar of stranded cost," according to Mr. Kevin Higgins of AECC.[75]

11. Growth factors would have to be addressed in the present value of the net revenue stream, which would otherwise be assumed by a buyer under the divestiture approach, according to Mr. James Gilliam of the Land and Water Fund.[76]

12. Underestimated future power sales or any key component of market price adjustments would result in overcollection of stranded costs, according to Dr. Richard Rosen.[77]

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[72] Dr. Alan Rosenberg Transcript 2270:8-21.

[73] Dr. Mark Cooper Transcript 2478:2-14 and 2489:2-9.

[74] Dr. Mark Cooper Transcript 2481:4-25; *see* Dr. William Hieronymus' response where he discussed the underallocated G&A costs to generation in PECO. Transcript 2694:21 to 2696:10.

[75] Mr. Kevin Higgins Transcript 4039:1-16.

[76] Mr. James Gilliam Transcript 1154:17 to 1155:8; *see* Dr. Kenneth Rose Transcript 3083:8-19.

[77] Dr. Richard Rosen Transcript 1899:13-23.

13. Factors other than competitive generation, such as changes in technology and demand, may affect the net revenue but nevertheless be included in the strandable cost calculation, as testified to by Dr. Mark Cooper for the Arizona Consumer Council.[78]

14. A "hazard . . in the net revenues lost approach is that you wind up overemphazing the near-term period when market prices are thought to be low, and ignoring the later period when the ownership of these assets might provide considerable value and revenues to the owners even, again, in excess of a regulated return. So that is the hazard, that it could be biased toward calculating a greater stranded cost than might otherwise be reasonable," according to Mr. Higgins of AECC.[79]

The administrative net revenues lost approach will also lead to costly, contentious hearings, in the opinion of some witnesses.[80]

B. Economic Modeling May Generate Manipulated Results

The administrative or net revenues lost approach requires the use of an economic model. Dr. William Hieronymus admitted that such a model may be manipulated to create the results desired by the maker.[81] For example, Dr. Hieronymus testified he participated in the Philadelphia Electric case, in which the calculation of estimated market prices, estimated costs, discount rates and cost allocation methods resulting in billions of dollars in changes in the stranded cost estimate by four witnesses for that utility.[82]

Ms. Mona Petrochko testified about the difference in stranded cost, dealing with the New England Electric System, in which the projected net revenue lost basis was in the neighborhood of $4 billion, but after divestiture, their stranded cost estimate had been reduced in half to about

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[78] Dr. Mark Cooper Transcript 2453:10 to 2454:15.

[79] Mr. Kevin Higgins Transcript 4037:1 to 4038:8.

[80] *See* Mr. Sean Breen Transcript 121:20-23.

[81] Dr. William Hieronymus Transcript 2639:15-24.

[82] Dr. William Hieronymus Transcript 2642:1 to 2644:11. Dr. Douglas C. Nelson Rebuttal Testimony at 5.

$2 billion.[83]

Market price assumptions may cause a large swing in the calculation of strandable costs. Dr. Kenneth Rose testified that he had conducted studies in which the net result was zero, with a $1.1 billion in loss for the low-price scenario and $1.1 billion in gain with a high-price scenario. In that situation, Dr. Rose suggested the amount of strandable cost ought to be small.[84]

APS' Dr. John Landon had no confidence in forecasting future electric prices: "I could almost guarantee that we'll get the wrong answer by a lot, and I don't know in which direction." He said we don't know what fuel prices, technological changes and environmental restrictions are on the horizon. "A miserable job" was done in the past to estimate electric prices and he didn't offer any improvement for the future.[85]

Dr. Rosenberg said he expects generation prices to rise in the future because today's wholesale generation prices are low -- the utility recovers the generation fixed costs from captive customers and then sell excess power in the wholesale "opportunity" market. But "given the drying up of excess capacity, the diminishing of the distortion effect of competitive transition charges, natural inflation, just about every forecast that I have seen of market prices project a rise."[86]

C. Indices Cannot Be Compared to Potential Strandable Generation Costs in Computing Stranded Cost Recovery

Considerable testimony was received on market indices, such as the Dow Jones Palo Verde Index and the California Power Exchange ("CPX"). They are "short-term wholesale

[83] Ms. Mona Petrochko Transcript 925:23 to 926:4 and 982:24 to 984:3.

[84] Dr. Kenneth Rose Transcript 3097:19 to 3098:21.

[85] Dr. John Landon Transcript 2884:9 to 2885:18; *see* 2906:8 to 2907:4.

[86] Dr. Alan Rosenberg Transcript 2216:1 to 2217:10.

energy prices" that the average retail customers would not likely pay in the long run.[87] **Use of these indices overstate the amount of strandable costs.** Another common weakness of these wholesale indices is that produce a market price for power not for utility assets, according to Dr. Alan Rosenberg.[88] Dr. Rose said that the CPX, if it ever gets up and running, might serve as "part of a clue" in discerning market price, but he didn't know if it should be the only factor.[89] But Dr. Richard Rosen acknowledged that these wholesale indices could not be built up to a retail value because no one knows what the long run cost of generation capacity might be.[90] Dr. Hieronymus pointed out another weakness of the CPX or a "pool" price: "So if I'm

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[87] Dr. Richard Rosen Transcript 1826:6-20 ("they're clearly a wholesale index."); Dr. Alan Rosenberg 2243:21 to 2245:24; Dr. Mark Cooper Transcript 2514:6-10 ("I guess the Palo Verde index as a measure of the market price of electricity. And as far as I can tell, that's an awful lot lower than the rate base price of electricity."); Dr. William Hieronymus Transcript 2602:4 to 2603:24 ("But the Palo Verde market today is indubitably an energy market, there is a capacity requirement in Arizona, which there is not in California, and therefore Californians aren't going to pay for capacity of Palo Verde, then that would be another piece you'd have to pick up from another market."); Dr. Kenneth Rose Transcript 3243:10 to 3244:8; AEPCO's Direk Minson Transcript 3054:2-9 ("in the Wall Street Journal at California, Cobb or West Wing, those prices are expressed for short-term power. In effect, what they represent is excess capacity that is on the market. It does not have, if you will, the cost of the -- the capital costs, if you will, of the generator, and therefore, are lower than otherwise would be the case."); APS' Jack Davis Transcript 3637:18 to 3640:2; 3678:1 to 3680:20 and 3686:11 to 3687:24 (discussion of CPX political pressure, money spent and complexities in attempting to get it up and running); AECC's Kevin Higgins Transcript 4044:17 to 4045:12 (CPX "is a wholesale price which will be subject to a retail markup."); Dr. Douglas C. Nelson Transcript 4184:24 to 4186:10.

[88] Dr. Alan Rosenberg Transcript 2246:6-12.

[89] Dr. Kenneth Rose Transcript 3239:2-15; Dr. Mark Cooper said the CPX approach in California proved to be quite difficult and expensive as well. Transcript 2503:9-18. Dr. John Landon testified the CPX is complex and not working, even significantly more than $200 million had been spent on this index created by the government. Transcript 2911:12 to 2913:9.

[90] Dr. Richard Rosen Transcript 1829:14 to 1830:14.

selling most my energy to myself, and I'm only selling a little, I can conceive of circumstances where I would not have a strong incentive to get as much from selling that little bit as I otherwise would have."[91]

Another serious weakness of the wholesale indices is that today it reflects a surplus market and therefore lower prices than when full open access occurs. Thus it creates a higher recovery of strandable costs. Mr. Mark Cooper said he agreed with other witnesses that we "have a market in surplus, it tends to sell down towards its variable costs plus whatever it can, as long as you're making accretion to your fixed costs, you keep selling."[92]

D. APS' Look-Back Approach Overstates Strandable Costs

Dr. William Hieronymus, testifying on behalf of APS, said that the loss of any customer by APS will not affect the calculation of strandable costs under its net revenues lost approach -- other customers will pay the CTC regardless of any change in customers.[93] Dr. Hieronymus defines stranded cost as "the difference between what you will get for selling electricity for the generation component of electricity under regulation versus the generation component of electricity under competition."[94] However, the <u>APS approach does not relate strandable costs to the advent of competition or uneconomic generation</u>. With the APS after-the-fact method, Dr. Hieronymus testified that the separation of transmission/distribution costs from generation costs had nothing to do with the calculation -- APS would receive the same revenues with or without competition with any shortages denominated as "stranded cost."[95] Furthermore, Dr. Hieronymus admitted that utility shareholders were compensated for some risks; nevertheless, the all-inclusive

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[91] Dr. William Hieronymus Transcript 2603:3-20.

[92] Dr. Mark Cooper Transcript 2484:21 to 2485:3.

[93] Dr. William Hieronymus Transcript 2568:18 to 2569:13.

[94] Dr. William Hieronymus Transcript 2601:20-24.

[95] Dr. William Hieronymus Transcript 2629:4-12.

revenue approach of APS does not recognize that prior compensation.[96] He described the APS approach as an interesting idea but he was not aware of anyone using a retrospective method in calculating stranded costs.[97]

Mr. Jack Davis of APS testified that if no customer left the system then the stranded cost calculation would be zero.[98] This appears to conflict with Dr. Hieronymus' testimony that is cited in the previous paragraph. Setting aside for the moment as to how price is determined, the APS approach does not address the loss of generation associated with a customer's purchase of competitive generation, when multiplying the "price" times the "quantity." Instead, the APS proposal uses its entire generation ("actual hourly loads") as the backstop in figuring stranded costs. Under this methodology, it would be possible for no customer to leave APS' generation and APS' sale of excess generation would be guaranteed the CPX price (plus transmission wheeling, CPX administrative charges, and transmission losses) through the stranded cost charge. There is never any identification of potential strandable generation capacity or energy -- if there ever was any.

Arizona consumers would be tied to the California Power Exchange price. Arizona customers would leave only if they could buy electricity for less than the price of the CPX, according to Mr. Davis, except where the competitor might offer better risk management or demand side services.[99] This is a major impediment to consumer choice. It unreasonably (if not unlawfully) delegates the Commission's ratemaking authority to a foreign governmental body, the California Power Exchange, in setting the market proxy for strandable costs.

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[96] *See* Dr. William Hieronymus Transcript 2581:15 to 2582:5.

[97] Dr. William Hieronymus Transcript 2634:11-18.

[98] Mr. Jack Davis Transcript 3641:6-13 and Schedule JED-2.

[99] Mr. Jack Davis Transcript 3719:7 to 3720:18.

The APS approach would not encourage mitigation of stranded costs. Mr. Davis testified "there's no adjustment for the generation costs; they are what they are." He did, however, acknowledge that "the load is what it is, but recognizing that we are in a growing mode in Arizona, and you'd have to make some sort of adjustment for growth volume."[100]

The time frame for assessing a stranded cost charge, under the APS proposal, is based on an unconfirmed estimate by the Western System Coordinating Council of when it believes that excess capacity might be absorbed in the Western United States.[101] This duration appears arbitrary. ECC asserts that this extensive recovery period would be anticompetitive to the extent customers must pay an extended surcharge in order to buy competitive generation.

Dr. John Landon testified the calculation time frame and stranded cost recovery time frame would match, under the APS proposal.[102] But in fact, the APS proposal would implicitly use its long term value of generation assets, as is implicit in its rates, for the full life of the plants, and compare those values to the short-term CPX wholesale index.[103]

Low near-term market prices would also result in overcollection of stranded costs, under the APS proposal. Mr. Davis, in describing the stranded cost issue, acknowledged that the supply of hydropower is a factor and he predicted that "this summer and fall we'll have low market prices."[104] Sale of excess hydropower will lower wholesale prices, including those reported by the CPX.

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[100] Mr. Jack Davis Transcript 3645:15 to 3646:4.

[101] Mr. Jack Davis Transcript 3646:5-11; 3701:23 to 3702:7; 3777:18 to 3778:7 (no assessments have been made of the reliability of WSCC's projections); and Direct Testimony at 10 and Schedule JED-3 (the Direct Testimony says "market price [will be] below the industry's long-run marginal cost for at least for the next 7 years" but the oral testimony refers to an 8 year recovery period).

[102] Dr. John Landon Transcript 2949:11-14.

[103] Mr. Jack Davis Transcript 3757:14 to 3760:17.

[104] Mr. Jack Davis Transcript 3652:3-18.

Conflicting opinions were offered as to the California generation market and its transmission to Arizona, for purposes of using the CPX. Dr. Hieronymus said sometimes there is a transmission constraint between them and power sometimes flow from Arizona to California.[105] Dr. John Landon, however, testified that there is a very robust transmission between Arizona and California.[106] Mr. Jack Davis of APS inferred there may be some constraints in wholesale transmission but he did acknowledge that "the real issue of market power, as I stated earlier, is who controls who operates the transmission system."[107]

For new entrants, the yearly change in the CTC will discourage, if not preclude, competitors from marketing in the APS service area. Neither the consumer nor new entrant will know until next year if the offered generation price, plus the fluctuating CTC, is more or less than APS' standard offer rate.[108]

In describing the APS proposal, Dr. Alan Rosenberg summed it up as a "lose/lose proposition" for consumers. The biggest gap between embedded or stranded costs and market price will be up until the year 2006, then after that the company is free to sell the plant. "[C]onsumers would end up with the worst of both worlds, they pay the transition charge over the period when market prices were low, and then once the market price has cleared, then the utility is free to make profits on it based on what the market price is."[109]

E. Regulatory Assets Associated With Generation Should Only Be Considered

Regulatory assets raise unique problems. The Electric Competition Rules contemplate the recovery of strandable costs attributable to competition. Initially only generation is being opened

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[105] Dr. William Hieronymus Transcript 2655:1-22.

[106] Dr. John Landon Transcript 2882:17 to 2883:8.

[107] Mr. Jack Davis Transcript 3753:12 to 3754:25 and 3780:6-14

[108] Mr. Jack Davis Transcript 3732:11 to 3737:11.

[109] Dr. Alan Rosenberg Transcript 2270:23 to 2271:22.

for consumer choice. TEP's Karen Kissinger testified that "approximately 65 percent [of TEP's regulatory assets] relate to generation."[110] Dr. William Hieronymus testified that some allocation of regulatory assets would be allocated to generation.[111] However, Mr. Benjamin McKnight testified for APS and said that the regulatory assets of APS have not be allocated among generation and other activities of APS. Instead, APS is focusing on "future cash flows" under its proposal. Mr. McKnight said that if the Commission required that those regulatory assets be part of the stranded cost calculation, then it would have to allocate them among the competitive generation and regulated distribution and transmission activities.[112] Mr. Jack Davis testified APS' regulatory assets were at risk in the 1996 agreement, they would be amortized over an 8-year period, and they would be included in the standard offer and as part of the "wires business."[113] To the extent those regulatory assets relate to competitive generation, those assets should be a component in the sale of excess generation and not collected as part of the "wires" distribution charge.

In tracking "income tax regulatory assets" attributable to generation, TEP's Karen Kissinger indicated there may be "gray areas, depends on how well the utility was able to keep its income tax record, whether all income tax assets, the deferred tax portions may not be as easily identified."[114] AEPCO's Dirk Minson said a few dollars associated with debt refinancing, "loses its identity and probably will be associated with the transmission part of our assets, so not all of [the regulatory assets are attributable to generation], but certainly a vast majority."[115]

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[110] Ms. Karen Kissinger Transcript 2980:16-17.

[111] Dr. William Hieronymus Transcript 2638:4-24.

[112] Mr. Benjamin McKnight Transcript 2412:23 to 2414:15.

[113] Mr. Jack Davis Transcript 3646:21 to 3647:16.

[114] Ms. Karen Kissinger Transcript 2979:15 to 2980:8 and 2980:9-22..

[115] Mr. Dirk Minson Transcript 3039:8-22.

F. FERC Order 888 Did Not Adopt a Net Revenues Lost Approach Similar to Those Proposed in this Proceeding

Reference was made to the Federal Energy Regulatory Commission's Order 888. RUCO's Dr. Rosen and ECC's Dr. Nelson claim that some mistakenly assert that FERC's approach is similar to those advocated in this proceeding.[116] In discussing FERC Order 888, Dr. Alan Rosenberg testified that "there has to be a reasonable presumption that that customer would have continued to buy from the utility, and then I believe they used some historic measure of what the customer has paid to the utility, and then I think the customers, the departed customer has the option to pay it or try and buy that power and then resell that power."[117] It contains a market phase in which the buyer can exercise the option to purchase that strandable generation asset for the value declared by the supplier, according Mr. Jack Davis.[118] FERC "reduced its administrative burden in dealing with the utility's estimate of stranded costs by saying that the leaving wholesale customer would have the right to take the power at that price," according to Dr. Hieronymus.[119]

ECC asserts that retail customers should receive the same benefits as wholesale customers, under FERC Order 888: pay no more than obligated to in the past, reasonable certainty as to the amount, and the ability to use market transactions in verifying the accuracy of the utility's stranded cost figure.

G. The Net Revenues Lost Approach Causes Anticompetitive Results

The net revenues lost approach is anticompetitive in that the incumbent utility can recover its cost of capital through strandable cost while at the same time the new entrant must obtain that

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[116] Dr. Richard Rosen Transcript 1821:34 to 1822:4; Dr. Douglas C. Nelson Rebuttal Testimony at 5-7; Transcript 4180:20 to 4183:12; Transcript 4217:16 to 4223:17; and Exhibit ECC-4.

[117] Dr. Alan Rosenberg Transcript 2247:4 to 2248:6.

[118] Mr. Jack Davis Transcript 3769:20 to 3770:4.

[119] Dr. William Hieronymus Transcript 2651:8-20 and 2653:3-19.

capital from the market and recovery it through its generation prices.[120] Dr. Mark Cooper concludes that this " . . . will destroy competition, and that will delay the onset of NEWCOs because they can't get their capital costs out of that market."[121] Dr. Kenneth Rose provided similar testimony by saying that strandable cost recovery distorts the price that may be offered by alternative suppliers: "The problem is that it tends, if you calculate an amount, it tends to distort the price that the customer pays. The utility is then competing based on just its incremental costs, while the alternative suppliers are based on their long-run marginal costs, which includes capital costs plus the amount that it added on from the unrecovered sunk costs of the utility."[122] Dr. Rose went on to testify that:

> . . . I am concerned about having, you know, one supplier, the incumbent utility competing based on incremental costs or short-run marginal costs and the new suppliers all paying the long-run marginal cost plus whatever they have to pay in terms of stranded costs.[123]

Mr. Higgins of AECC suggested that the Commission may wish to consider "a haircut" on the return on equity, as articulated by Dr. Fessler, as one way in which to resolve this issue in any stranded cost calculation.[124]

Another criticism of the administrative net revenues lost approach is that regulators don't know where to look for the efficiencies that the utility might have reduced costs. Consumers and

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[120] *See* Dr. Kenneth Rose Transcript 3094:19-25; Mr. Jack Davis Transcript 3755:16 to 3757:1.

[121] Dr. Mark Cooper Transcript 2455:24 to 2456:2 and 2477:19 to 2478:1.

[122] Dr. Kenneth Rose Transcript 3119:1-15 and 3181:6-13 (recovery surcharge gives an advantage to incumbent utility, particularly if it has low variable costs).

[123] Dr. Kenneth Rose Transcript 3234:4-9.

[124] Mr. Kevin Higgins Transcript 4042:12 to 4043:17.

competitors are at a disadvantage in receiving and evaluating cost information. And hearings do not necessary illuminate.[125]

XII. Aggregation Should Be Encouraged to Assist Small Consumers

There should be no constraints on the ability for people to aggregate, because "[t]he little guys in this fight need all the help they can get," said Dr. Mark Cooper.[126] Enron's Mona Petrochko testified: "The benefit of marketing to residential customers is that you have the opportunity to aggregate hundreds of thousands of them, if not millions of them in, for example, the California market together, and generate benefits by that aggregation.[127] ECC strongly supports the aggregation of consumers, in part so as to make residential and low income power usage attractive to the competitive generation industry.[128]

XIII. Competitive Electric Service Providers Benefits for Residential, Small and Rural Consumers

"Competition is the consumer's best friend . . ," according to the Arizona Consumers Council's Dr. Mark Cooper.[129] Similarly, Mr. Daniel Fessler supported the use of competitive services in all aspects of electric deregulation where they can be effectively done. He testified: "I think that if you're going to move in the direction of competition, that ultimately the public interest is best served in trying to substitute competitive forces for regulated monopolies in any area where you become convinced that that can effectively be done."[130]

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[125] *See* Dr. Mark Cooper Transcript 2539:16 to 2542:24 and Mr. Kevin Higgins Transcript 4041:14 to 4042:11.

[126] Dr. Mark Cooper Transcript 2489:22 to 2487:5.

[127] Ms. Mona Petrochko Transcript 878:17-25.

[128] Dr. Douglas C. Nelson Transcript 4202:11 to 4203:1.

[129] Dr. Mark Cooper Transcript 2463:3-6 and 2543:11-20 ("I was a big supporter of the Energy Policy Act of 1992. We had hoped and expected that vigorous competition on the wholesale side would discipline folks, and it has.").

[130] Dr. Daniel Fessler Transcript 453:20-25.

Ms. Mona Petrochko testified that residential customers will receive benefits from competition, including reduced costs and additional services. She acknowledged that each competitor seeks its own market niche, and there are only so many industrial and commercial customers to go around. In serving rural Arizona, Ms. Petrochko said: "We don't particularly see any technical reason why we can't serve a rural customer as well as an urban customer."[131]

Dr. Richard Rosen, testifying on behalf of the Residential Utility Consumer Office, said the number one priority for residential customers is to receive lower rates, and he could not see why that would not occur under competitive markets.[132] The standard offer backup rate must be "at a realistically high retail market price," otherwise there will be no generation competition, similar to what occurred in Rhode Island and Massachusetts, according to Dr. Rosen.[133]

Dr. Kenneth Rose testified that empirical analysis in other industries that have deregulated show that ". . .there have been significant cost improvement in just about all the inputs that the companies use in terms of capital and in terms of labor and in terms of energy used, these and other materials. They often are -- these improve with the introduction of competition, and represent basically an improvement over cost of service."[134] Later Dr. Rose emphasized that if done properly competition will bring benefits to all consumers, both large and small. With aggregation, he also believes that residential customers will have the same amount of marketability as large customers.[135] Furthermore, he testified that "it's vitally important that

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[131] Ms. Mona Petrochko Transcript 858:21 to 860:15.

[132] Dr. Richard Rosen Transcript 1809:10-14.

[133] Dr. Richard Rosen Transcript 1809:18 to 1811-10 and 2030:8-25.

[134] Dr. Kenneth Rose Transcript 3090:8-18.

[135] Dr. Kenneth Rose Transcript 3108:18 to 3111:8.

barriers to entry be very low, or as low as possible for new entrants" and competition provides opportunities for product innovation.[136]

AECC's Dr. Alan Rosenberg said residential customers will benefit from competition in both the short and long run, from lower rates, better service, and increased economic activity resulting in more jobs.[137] Arizona Consumer Council's Dr. Mark Cooper suggested that billing and metering should eventually be open to competition, but we should start with generation because we have evidence that it can be competitive.[138]

APS' Dr. William Hieronymus testified that "having a competitive generation market can help customers a lot, I'm convinced of that."[139]

Some utilities have suggested they are entitled to future strandable costs because of their "obligation to serve" or as "the provider of last resort." In response, Dr. Kenneth Rose recommended that the this service could be bid out to somebody else if they did not want to provide the service, and he felt that was within the spirit of the Commission's original order.[140] Citizens Utilities' Sean Breen also suggested that utilities could purchase standard offer generation during the transition period.[141] Mr. Albert Sterman of the Arizona Consumer Council said he would support the competitive bidding of generation used by the provider of last resort.[142] Dr. Cooper also strongly supported the competitive bid of generation used in the standard offer --

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[136] Dr. Kenneth Rose Transcript 3209:5-7 and 3226:8-21.

[137] Dr. Alan Rosenberg Transcript 2191:7 to 2192:4..

[138] Dr. Mark Cooper Transcript 2548:25 to 2549:25.

[139] Dr. William Hieronymus Transcript 2604:12-25.

[140] Dr. Kenneth Rose Transcript 3102:13 to 3103:9 and 3238:9-21.

[141] Mr. Sean Breen, Transcript 194:21 to 195:10.

[142] Mr. Alan Sterman Transcript 2376:22 to 2377:4.

"Standard offer kilowatts ought to be the best price I can get, . ."[143] The competitive bid of a portion of the standard offer generation might also be used as a means of valuing generation assets that are not divested.[144]

XIV. No Distortion of Competitive Generation Prices Should Occur Under Any Stranded Cost Mechanism

The consensus seems to be that regardless of the method it should not distort the competitive price of generation or impede the ability of electric providers to sell their generation competitively. TEP witness Dr. Kenneth Gordon testified, in respect to the stranded cost recovery and any net profits: "But you ought to do so in a way that doesn't distort the competitive market. Don't try and shade the price of power in the market. Find some other way to flow that benefit through if, indeed, it is a benefit that's attributable to earlier investments of ratepayers so that it, so to speak, belongs to the ratepayers."[145]

Dr. Mark Cooper testified at length about the distortion problem that occurs when utilities receive a return of and on their capital and others do not.[146] He said that "the new entrants are always competing against the standard offer because that's were my clients [residential consumers], my constituents will go."[147] Similarly, APS' Jack Davis testified: "During the transition period, customers will be allowed to switch from the competitive offer to the standard offer so that, in effect, caps the customer's risk, so to speak, as to what their price will be."[148] The "headroom" between that offer and the combined stranded cost charge and the utility's

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[143] Dr. Mark Cooper Transcript 2487:6 to 2488:10 and 2505:10 to 2506:4.

[144] *See* Transcript 4036:9-25.

[145] Dr. Kenneth Gordon Transcript 715:9-18 (emphasis added).

[146] Dr. Mark Cooper Transcript 2480:16-23.

[147] Dr. Mark Cooper Transcript 2487:10-20.

[148] Mr. Jack Davis Transcript 3671:7-11; *concur* Dr. Douglas C. Nelson Transcript 4184:6-23.

transmission/distribution/auxiliary charge is the generation component which new entrants must work with.[149] Mr. Kevin Higgins testified "as long as there is a standard offer option available to customers, the higher the transition charge is, the greater the hurdle there is for the new entrant to compete with the that, standard offer."[150] Dr. Hieronymus described this phenomenon in California and explained why customers were not leaving: " . . .[O]ne of the reasons that the utilities aren't losing customers is precisely because they're charging a market price given the CTC for energy." After the CTC recovery period he expects the utilities will lose a fair amount more customers.[151]

Drs. Richard Rosen and Kenneth Rose recited the Massachusetts experience, and the Rhode Island experience where stranded costs were calculated using low market prices. Later the market price became higher because some key power plants went down. As a consequence, the high stranded cost charge of 2.8 cents is added to a high generation charge, so that new entrants cannot compete effectively.[152]

If the stranded cost charge is high and in place for a long time, it would act as a market barrier and be harmful to consumer choice, according to AECC's Dr. J. Robert Malko.[153] Ms. Petrochko of Enron said that very high stranded costs "would very much inhibit the ability of competitors to enter the Arizona market and provide the services that I mentioned earlier."[154] Similarly, Dr. Alan Rosenberg testified that a high stranded cost charge is most damaging to the goals of retail access and it narrows the universe of potential competitors so as to increase the

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[149] Dr. Douglas C. Nelson Transcript 4195:1 to 4197:9.

[150] Mr. Kevin Higgins Transcript 4044:2-16.

[151] Dr. William Hieronymus Transcript 2599:5-15 (quote) and 2690:9-25.

[152] Dr. Richard Rosen Transcript 1881:9-24; Dr. Kenneth Rose Transcript 3230:17 to 3231:12.

[153] Dr. J. Robert Malko Transcript 2140:4-22.

[154] Ms. Mona Petrochko Transcript 848:5-16.

market power of incumbents.[155]

XV. Subsidization of Affiliate Competitive Transactions of Utilities Should Not Be Allowed

"The consumer's worst enemy is unregulated monopoly power," said Dr. Mark Cooper of the Arizona Consumer Council.[156] Cross-subsidies between the regulated activities of a utility and its merchant or competitive marketing activities should be prohibited. This is a concern of Dr. Kenneth Rose, and he believes the continued regulation of distribution and transmission services should help to prevent that problem.[157] Dr. Rosenberg testified that if competition enhanced the name recognition of the utility then that enhanced value of the utility could be used as a negative stranded cost.[158]

APS has been marketing retail generation in California since 1997 and 1998 under the commercial operations business unit. Those costs are presently being separated within the bulk power marketing unit, with an income statement and bookkeeping in that unit. However, APS has not filed any unbundled rates with the Commission to illustrate how overhead and G&A costs are being allocated.[159]

Dr. Mark Cooper strongly supported divestiture as a means of preventing affiliate abuses:

> I would much prefer to have them divest. Vertically integrated entities are extremely difficult to prevent them from abusing their affiliate relationships.
>
> We struggle mightily with affiliate relationships in the telecom industry. I prefer divestiture. I frequently don't get it. And so then I fall back on what I call draconian regulation. And I don't flinch from calling it that, because affiliate transactions are fraught with the risk of abuse. And we call it the code of conduct

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[155] Dr. Alan Rosenberg Transcript 2238:22 to 2240:10 and 2297:7 to 2298:2..

[156] Dr. Mark Cooper Transcript 2507:22-25.

[157] Dr. Kenneth Rose Transcript 3235:1-14.

[158] Dr. Alan Rosenberg Transcript 2249:11 to 2250:4.

[159] Mr. Jack Davis Transcript 3773:1 to 3775:10.

> in electricity, I think is the euphemism that's been used for it, but code of conduct is too nice sounding a word. Affiliate transactions are pernicious. They will be abused in every way, shape, form and fashion. And therefore, we have to regulate them severely. In most places, we end with vertically integrated entities, and we have to regulate them severely.[160]

APS' Dr. William Hieronymus said he it was not necessary for utilities to create an affiliate for their merchant functions but he recommended it because it would preclude cross-subsidies and keeps the risks and rewards separated between activities.[161] Likewise, APS' Dr. John Landon testified if a company is going to compete, particularly in its own service area, supported an "entity fenced ringed from the rest of the operation in terms of preventing cross subsidies and ensuring that unfair advantage of the vertical relationship is not taken." Dr. Landon also suggested that the Commission set up accounting rules and reporting requirements when utilities operate in unregulated markets.[162]

XVI. Recovery of Strandable Costs Must Be Linked to Competitive Generation Sales and Not as a Condition to Serving Customers as a Last Resort

Until there is competitive sales of generation, there is no potential strandable cost. The consensus appears to be that any recovery of strandable costs must be linked directly to the opening of retail generation markets.[163] TEP Chairman Bayless said that: "I think the duty to serve customers, as a last resort, to me in some measure comes down to whether we get stranded

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[160] Dr. Mark Cooper Transcript 2493:10 to 2494:3 (above quote); 2546:19 to 2548:24; and 2556:8 to 2557:11.

[161] Dr. William Hieronymus Transcript 2656:19 to 2657:16.

[162] Dr. John Landon Transcript 2920:4 to 2922:2; *see* 2951:15 to 2953:11..

[163] PG& E Energy Services Mr. Douglas Oglesby testified that: "I have seen no evidence yet that the Arizona utilities are willing to cooperate to open up retail competition. Indeed, I have seen precisely the contrary. So I think allowing the utilities to recover stranded costs without linking it directly to cooperating on competition would mean utilities would recover stranded costs, and we still wouldn't have competition." Transcript 1350:15-22.

costs or not this time."[164] Mr Bayless indicated that generation on the spot market would be available. Consequently, the Commission could link the duty to service with the obligation to purchase competitive generation to serve standard offer customers so as to avoid incurring additional strandable costs and the quid pro quo suggested by Mr. Bayless.

XVII. Securitization Is Proposed by TEP and Does Not Appear to Be A Viable Option

TEP has suggested the use of securitization; however, Chairman Bayless recognized that it would require legislation before it may be implemented.[165] PG&E Energy Services Mr. Oglesby indicated he would not be opposed to securitization.[166] Enron's Ms. Petrochko suggested that securitization may make sense if the assets have been valued and stranded costs have been determined, and it would lower the cost to consumers.[167] Citizens' Sean Breen indicated that he would consider securitizing stranded costs.[168] Dr. Kenneth Rose, however, testified he opposed securitization because it "giving the utility an assurance that they have never had before," and it would be "securitizing, not the asset but that revenue stream."[169] Dr. Mark Cooper described securitization as "a financial gimmick" which avoids the question of why costs are uneconomic and how they should be allocated.[170]

XVIII. Utilities Should Have an Opportunity to Recover Their Strandable Cost

Many witness supported the notion of an opportunity versus an absolute 100% guaranteed

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[164] Mr. Charles Bayless Transcript 1521:9-11.

[165] Mr. Charles Bayless Transcript 1556:9-13.

[166] Transcript 1569:4-9.

[167] Ms. Mona Petrochko Transcript 965:4-10.

[168] Mr. Sean Breen Transcript 101:15-17 and 242:18 to 244:24..

[169] Dr. Kenneth Rose Transcript 3166:13 to 3167:8 and 3223:5 to 3224:1.

[170] Dr. Mark Cooper Transcript 2482:1 to 2483:9.

recovery of strandable cost.[171] Some witnesses contested whether strandable costs should only be recovered from consumers, and not shared with shareholders.[172]

Dr. Kenneth Rose testified his review of information from stock and bond companies indicated that they were not expecting full recovery of strandable cost.[173] By allowing full stranded cost recovery, Dr. Rose refers to this as "a moral hazard" in which utilities will not behave the same way as if it were partial recovery. He made an analogy to those overusing a hospital emergency room if the costs will be reimbursed, the wrong incentive message is being sent.[174]

XIX. No Credible Evidence of a Regulatory Compact Has Been Presented Requiring the Predetermination of Strandable Cost Recovery Before Competition May Occur

Electric competition has been on the horizon for many years. Dr. Kenneth Rose found references to retail competition, in a broad sense, going back to the 1940's, and he said stock and bond rating agencies talked about retail competition in the mid-1980's.[175] The 1955 territorial

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[171] Dr. Daniel Fessler Transcript 458:15-23 "I believe that a restructuring plan should provide the incumbent utilities with an opportunity to recover 100 percent of those shareholder funds that they have invested in plant and equipment that may be strandable, owing to the Commission's decision to introduce competition in Arizona." Mr. Charles Bayless Transcript 1571:6-19 "I mean an opportunity to earn, I do not mean a guarantee." Dr. Kenneth Rose Transcript 3153:22-24: " . . . it [the notion of a regulatory compact] doesn't say 100 percent guarantee is assured." APS' Benjamin McKnight Transcript 2404:15 to 2405:17 (Decision No. 59601 on regulatory assets gives APS the opportunity but not guarantee to recover them through rates); Dr. Mark Cooper Transcript 2532:2-8. APS' Dr. William Hieronymus Transcript 2573:17-24 (". . . the utility should have a reasonable opportunity to recover 100 percent of stranded costs."). TEP's Karen Kissinger 2968:7-13 & 2979:6-10 (" . . . it's an opportunity. . . as opposed to a guarantee").

[172] ACC Staff's Dr. Kenneth Rose Transcript 3078:13-15 (not 100%)

[173] Dr. Kenneth Rose Transcript 3162:23 to 3165:4.

[174] Dr. Kenneth Rose Transcript 3231:13 to 3233:4.

[175] Dr. Kenneth Rose Transcript 3161:3 to 3162:22.

agreement between APS and the Salt River Project, and the creation of special districts and municipal utilities addressed competitive electric services.[176]

Dr. Michael Block testified he worked on a project for the Arizona Corporation Commission in 1985, recommending that the "utilities should spin off their generation."[177] TEP Chairman Bayless said he wrote a paper in 1987 called "Requiem for an Industry" where he first started espousing competition.[178] Mr. Walter Meek said his Arizona Utility Investors Association published a brochure in late 1993 or early 1994 that said: "Government policies and economic conditions are thrusting traditional monopolies into competition."[179] Dr. John Landon testified that competition between government-owned entities and public utilities have occurred for 50 years or more.[180]

Dr. Richard Rosen testified he began discussing this issue of stranded cost, which he refers to as "uneconomic capacity," some 15 years ago -- years before some claim that retail competition was known.[181] Dr. Alan Rosenberg also said there were talks of retail wheeling in the 1980's.[182]

A. Regulation Mimics the Competitive Marketplace

Over the years regulators have attempted to <u>mimic the competitive marketplace</u> as a

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[176] *See* Transcript 3765:16 to 3766:24.

[177] Dr. Michael Block Transcript 3483:14 to 3484:15 ("This is before the British deregulated.")

[178] Mr. Charles Bayless Transcript 1512:1-4.

[179] Mr. Walter Meek Transcript 4289:2-19.

[180] Dr. John Landon Transcript 2923:2-24.

[181] Dr. Richard Rosen Transcript 1896:6-11.

[182] Dr. Alan Rosenberg Transcript 2296:3-13.

fundamental part of regulation, according to Dr. Mark Cooper.[183] Similarly, Dr. Kenneth Rose testified that his review of history indicates that these are "revocable monopoly right[s] that can be taken away at the discretion of the state. They are granting that monopoly and then holding them to some kind of a standard that tries as best as possible to mimic what would happen in a competitive environment."[184] For example, "the use and useful test is synonymous more or less with, historically at least, with a fair value type of estimate and mimics the competitive market in that way," according to Dr. Rose.[185] From 17 years experience, Dr. Alan Rosenberg testified "that a general objective of regulation is to serve as a surrogate for competition until competition is possible."[186] APS' Dr. John Landon testified that "the cap on rate of return was meant to mimic the competitive market, which would otherwise hold prices at competitive levels," so he agreed that the role of rate regulation is to mimic competition.[187]

APS' Dr. John Landon testified that "retail incentive regulation is a substitute for competition, a partial substitute for competition, in that it provides incentives for companies to

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[183] Dr. Mark Cooper Transcript 2453:10-15; 2498:3-14; and 2532:14 to 2533:6 (" . . in the testimony of Mr. Fessler and Mr. Gordon where they both explicitly said that they were not trying to mimic competition, they disparaged that, and I think that is fundamentally wrong. I think that if that's what they believed at that time, they were not doing their job as commissioners, because they had a responsibility to ratepayers."); 2538:8-20("even when commissioners are doing their job of ensuring efficient prices, which means mimicking the marketplace, as I think they're suppose to do, obviously, marketplaces are better at discovering efficiencies and demonstrating efficiencies, and I think that's one of the reasons we have consistently tried to inject more market forces into the regulatory arena.").

[184] Dr. Kenneth Rose Transcript 3155:2-9 and 3227:6-19..

[185] Dr. Kenneth Rose Transcript 3228:2-21.

[186] Dr. Alan Rosenberg Transcript 2312:22 to 2313:1.

[187] Dr. John Landon Transcript 2872:12 to 2875:16. Dr. Landon did say however to the extent cost of service for large and small customers did not match the rates they paid, it did not mimic competition.

do a better job in managing their costs, but it, in itself, is not competition."[188]

Monopolies are disfavored in Arizona. The State Constitution states concisely and plainly that "monopolies and trusts shall never be allowed in the State." Ariz. Const. Art. XIV, section 15. The subsequent Article XV then discusses the composition and workings of the Arizona Corporation Commission in regulating public service corporations, including the setting of "just and reasonable classifications to be used and just and reasonable rates and charges" and the making of "reasonable rules, regulations, and orders." Ariz. Const. Art. XV, section 3. Competitive services are favored in Arizona and the Commission has the broad discretion in setting just and reasonable rates for competitive generation and the framework for strandable cost recovery, under the Electric Competition Rules, so that its regulations continue to mimic competition.

B. The Commission Has Discretion as to How It Treats Strandable Costs

Dr. Kenneth Rose testified that, like many economists, he has problems with the concept of "stranded costs," in part because there are no stranded costs. Therefore, he prefers the term "transition costs," "sunk costs above market," or "uneconomic costs," although he has never been able to settle on a term he really likes.[189] He is of the opinion that any notion of a regulatory compact does not guarantee 100 percent recovery of what are being classified as stranded costs. Dr. Rose further testified he believes "the Commission [has] a great deal more discretion in dealing with these kinds of costs than I think is often portrayed by those that are arguing there is, in fact, a regulatory compact."[190] APS' Dr. William Hieronymus also admitted

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[188] Dr. John Landon Transcript 2924:3-7; *see* Mr. Jack Davis 3766:25 to 3767:14..

[189] Dr. Kenneth Rose Transcript 3083:22 to 3084:23.

[190] Dr. Kenneth Rose Transcript 3152:16 to 3153:24.

that the Commission has discretion in adopting various methods for recovering strandable costs, including the level and rate of change in any CTC.[191]

On the issue of revaluing assets for ratemaking purposes, APS' Dr. John Landon testified that the Commission could review whether the utility's actions were prudent:

> . . . I think, which is if the company did something imprudent which caused an asset to decline in value to the ratepayers, that I think the Commission ought to look at what the company did and what they were responsible for, and take appropriate action to mitigate that on behalf of the ratepayers.[192]

On the issue of fair value, Dr. Rose agreed that rates based on competitive markets are also based on the fair value of the generation plant. He testified that using these competitive markets to determine the fair value of utility assets and control costs is not arbitrary and capacious, and that the use of market forces provides a better means of disciplining costs in the public interest.[193] Based on historical precedence, he testified that "fair value meant replacement value" and since Arizona is a "fair value" state it would be easier for Arizona to move towards competition.[194] Dr. Rose went on to admit that the fair value method is intended to mimic or as a surrogate for competitive markets.[195]

On the issue of determining fair and reasonable rates, Dr. Mark Cooper testified: "The concept of just and reasonable [rates] and return commensurate with risk are fundamentally linked to the notion of the competitive marketplace."[196] Dr. Rose testified that the competitive market

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[191] Dr. William Hieronymus Transcript 2645:3-16 and 2646:18-24..

[192] Dr. John Landon Transcript 2936:4-14.

[193] Dr. Kenneth Rose Transcript 3225:15 to 3226:21.

[194] Dr. Kenneth Rose Transcript 3156:15-25.

[195] Dr. Kenneth Rose Transcript 3157:9-24.

[196] Dr. Mark Cooper Transcript 2498:8-14 and 2498:19-22 ("It [the Commission] sets rates based on analysis of risk and reward, which are the essence of what drives the competitive model.")

is a superior means in which to determine those rates, in the public interest.[197]

On the issue of a reciprocal obligation to serve in exchange for strandable cost, Dr. Rose testified that there never was nor is there now a concurrent obligation to buy on the part of customers of the utility. He said:

> I believe strongly that that is, that the customers never really -- there was not a concurrent obligation on the part of customers like there was on the part of the utility to buy from a particular -- when customers leave a service territory or self-generate, generally they don't charge the customer who is leaving for what might be considered their obligation, if they have one. We simply have not done that in the past.[198]

Dr. Richard Rosen concurred by testifying: "If a customer leaves the system, well, I'm not aware of any regulatory principle that's ever been applied by a Commission to impose a charge on the electricity you don't buy in the future. If you're getting any service at all from that utility, I don't see a basis for charging."[199] Furthermore, Dr. Mark Cooper testified that cities could municipalize and generate their own generation for its citizens if it so desired.[200]

Dr. Alan Rosenberg also testified that utilities have costs or investments above market value before customers had choice. The mere fact that consumers have choice does not create strandable cost. Opening up of markets merely reveal those strandable costs.[201]

When asked "what's caused this phenomenon of strandable costs," Dr. Mark Cooper responded:

> In my opinion, it was a series of management decisions about which plants to build by specific utilities. Lots of utilities don't have any stranded costs. And the difference that I observe between utilities

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[197] Dr. Kenneth Rose Transcript 3159:24 to 3160:12.

[198] Dr. Kenneth Rose Transcript 3229:4-13.

[199] Dr. Richard Rosen Transcript 1820:6-13.

[200] Dr. Mark Cooper Transcript 2534:10 to 2537:23.

[201] Dr. Alan Rosenberg Transcript 2189:19 to 2190:12.

> that do and don't had to do with choices that were made by utility management.[202]

Dr. Cooper interprets the notion of a "regulatory compact" as a commitment by the Commission to keep the utility from real bankruptcy:

> As someone said to me a few days ago, capitalism without bankruptcy is like Catholicism without hell. That commitment gives them [the utilities] protection against a certain amount of risk in the marketplace, but I think that is where I sort of -- how I define the "regulatory compact."[203]

Dr. Cooper said he did not like the word "compact" because it "gives people the notion that it's written down someplace and we can pick it up and read it and we know all the terms and conditions. It's not. It's evolved through legal practice." He testifying that the Commission was obligated to allow a just and reasonable rates to consumers and a return commensurate with risk to utilities. It allows an opportunity for compensation to the utility, and "the quid pro quo was that the utility was obligated to do so in an economical fashion."[204]

Dr. Michael Block of The Goldwater Institute admitted that the regulatory compact theory is based on naive assumptions.[205]

The utilities have asserted that a "regulatory compact" or "regulatory contract" requires the Commission to "award" them with an undisclosed about of stranded cost recovery, in the appeal of the Electric Competition Rules and in this proceeding. ECC asserts that this issue has been decided or is under the jurisdiction of the Maricopa County Superior Court and now the Arizona Supreme Court, by virtue of the recent special action filed by AEPCO et. al.[206]

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[202] Dr. Mark Cooper Transcript 2469:11-19.

[203] Dr. Mark Cooper Transcript 2475:16-21.

[204] Dr. Mark Cooper Transcript 2496:19 to 2498:2.

[205] Dr. Michael Block Transcript 3483:4-13.

[206] *Tucson Electric Power Co. v. Arizona Corporation Commission*, No. CV 97-03748 (Consolidated) Superior Court of Maricopa County; *Arizona Electric Power*

Therefore, any issue pertaining to the nature of or the significance of "a regulatory compact" is now within the purview of the judiciary on appeal.

No credible evidence was presented by the utilities to illustrate that any utility relied on this theory prior to making any of their previous management decisions or was raised before, when the Commission changed rates or tariffs. At best, the utilities offer a theoretical or textbook argument that this "regulatory compact" theory may be a basis for rationalizing the payment of strandable costs by ratepayers.[207] We urge that these arguments, of the notion of a regulatory compact or contract, be rejected. We renew and incorporate by reference our prior arguments, including the previous decisions of the Maricopa County Superior Court, in support of our position.

XX. Reservation of Objections/Arguments and Conclusion

ECC preserves its prior objections and arguments made in this proceeding, without restating them in this Brief. Furthermore, ECC reserves the right to join in or adopt any other objection or argument raised by any other party to this proceeding.

In closing, ECC strongly supports the market approach to strandable cost calculation and recovery, and ECC vigorously opposes any version of the net revenues approach as creating any entitlement to strandable cost.

Cooperative, Inc. et al. v. Superior Court of the State of Arizona In and For the County of Maricopa and The Honorable B. Michael Dann, No. 98-0146-SA, Arizona Supreme Court; *Trico Electric Cooperative, Inc. v. The Honorable B. Michael Dann*, CV 98-0147, Arizona Supreme Court.

[207] Dr. Eugene Coyle testified: "So far as I know, the phrase a, quote, regulatory compact, close quote, did not appear in economic printed books and articles until deregulation and the issue of stranded cost became important to utilities." Transcript 1023:4-8. Dr. Coyle later testified " . . . I have been doing this since 1962, and I never heard of a regulatory compact, and so I have looked at the literature." Transcript 1081:18-20. In both his prefiled and oral testimony, Dr. Coyle testified that " . . . I find the claim of a regulatory compact as proposed by the affected utilities to be a weak justification for granting stranded costs." Transcript 1101:13-25.